



Negative Interest Rates and Real Estate Contracts

As [noted previously](#) by one of our [Private Client Solicitors](#), [Kurt Lee](#), the Bank of England has asked that UK banks and building societies consider their “operational readiness” for the introduction of a zero or negative base rate.

The potential for this has arisen due in particular to the continuing economic impact of COVID-19, coupled with a potential ‘no-deal’ exit from the Brexit transition period. Although the Deputy Governor has stressed that such a base rate cut is by no means inevitable, clearly, it remains a possibility [\[click here to read more\]](#). Central banks in Sweden, Denmark, Switzerland and Japan have all experimented with negative central interest rates.

Recently, one of our [Real Estate Solicitor](#)’s was asked by a concerned landlord client: “...*Will we have to pay interest to the tenant who is in arrears?...*”, and the introduction of a negative base rate clearly has the potential to affect the application of some base rate related provisions in commercial real estate contracts, including business leases and conditional sale agreements.

In many leases, the usual format for the default interest provision would be to impose an obligation on a tenant to pay interest at a percentage on top of the current base rate. In a zero or negative base rate scenario, tenants, in all likelihood, would still face a positive interest payment obligation depending on how many percentage points above the base rate the relevant default clause prescribes. However, where the default interest rate clause imposes an obligation to meet the base rate only, a tenant could argue that any arrears owing should diminish over time, rather than increasing as the clause had most likely intended.

In either scenario, the penalty interest would become less of a penalty, and, therefore, a less meaningful deterrent.

A negative base rate may force banks and building societies to pay (rather than receive) interest on their cash deposits held by the Bank of England. The banks would very likely look to mitigate & recover these costs. Although individual bank account holders are for the most part less likely to suffer interest charges or fees on their account deposits, examples from abroad suggest that this may be a more likely prospect for those with larger cash deposits, such as rent deposit accounts.

Under a typical rent deposit deed, the tenant is usually required to top up any reduction to the deposit sum to ensure that it will always comprise of a minimum deposit value. If the bank were to introduce an interest charge

or other fees due to a negative base rate, the tenant may find itself receiving regular and unwelcome demands from the landlord to supplement the deposit sums so as to make up for the interest or fees related shortfall.

Rent deposit deeds also often require that the deposit sums be held in an “interest bearing” bank account, particularly with larger or longer-term rent deposits. It is debatable whether a bank account with a negative interest rate would still be treated as “interest bearing” for this purpose.

The introduction of a negative base rate in the UK may not be imminent but is clearly an option that the Bank of England’s Monetary Policy Committee is considering. In the meantime, our [Real Estate team](#) are on hand to assist with related queries and concerns. Please email online.enquiries@la-law.com or call 01202 702645 to talk to one of our Real Estate Solicitors.